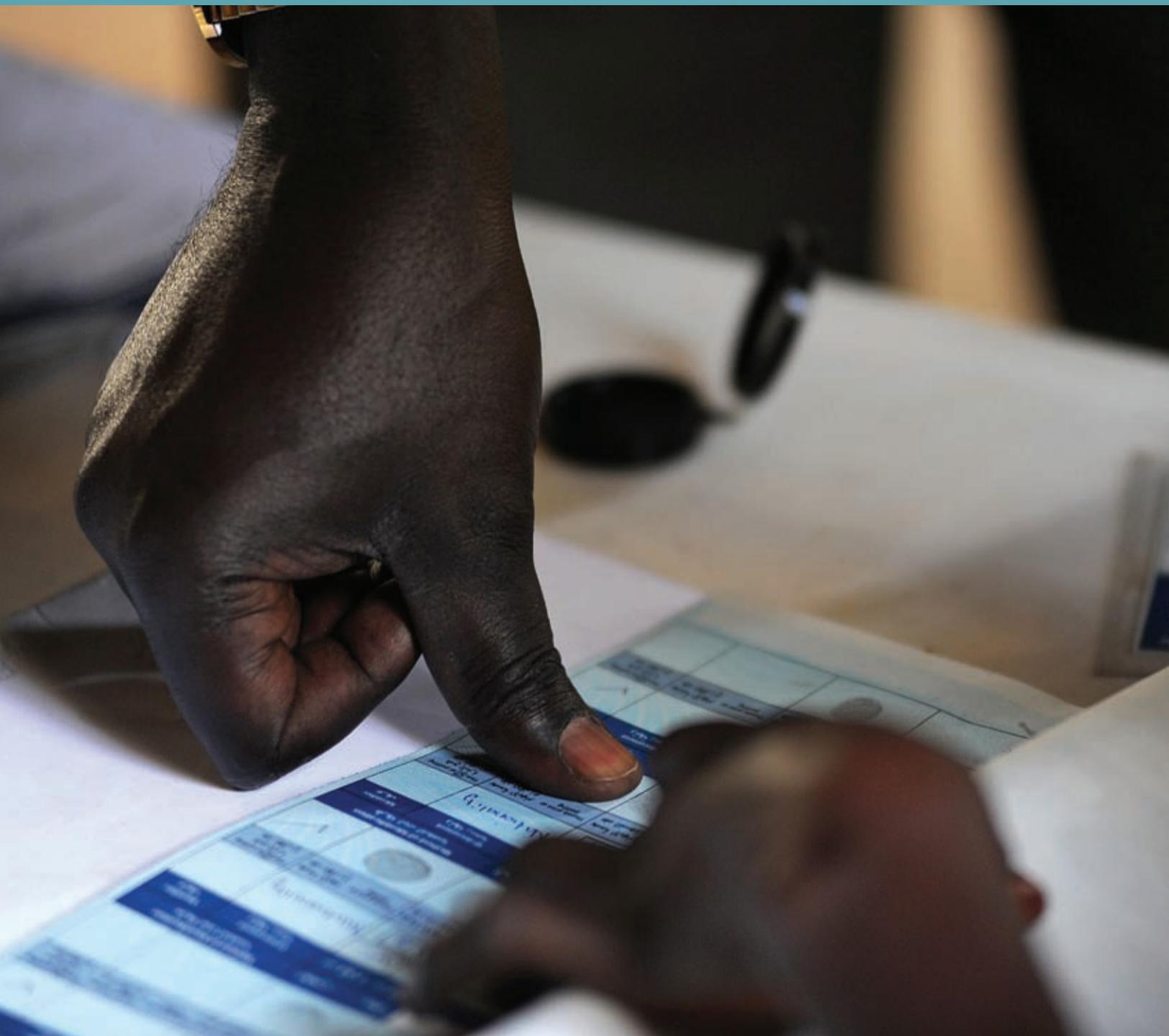


8

GOVERNANCE PRINCIPLES, INSTITUTIONAL CAPACITY AND QUALITY



The resilience of nations is manifest in their ability to anticipate and prepare for shocks, which, in turn, depends on the technical capacities of organizations and institutions at the front lines of crisis response, the overall functioning of country systems, and the governance structures that 'set the rules of the game'.



Introduction

During times of economic crisis, the resilience of nations is manifest in their ability to anticipate and prepare for shocks and effectively manage crises as they unfold. The ability of governments to design and implement the right combination of short- and long-term policy measures is thus critical for sustaining MDG progress and building greater resilience over time. Determining the appropriate policy measures is complex, though. On the one hand, it requires specific technical capacities in the organizations and institutions at the front lines of the crisis response. On the other hand, it depends on the overall functioning of country systems and institutional qualities, including decision-making processes and consensus building among key stakeholders, the broader political economy dynamics, and governance structures that largely set ‘the rules of the game’.

This chapter identifies the institutional qualities and governance principles that are critical for developing and implementing effective and equitable policy measures to mitigate the impact of economic crises. These institutional qualities are performance, adaptability, and stability; the main governance principles are participation/inclusion, non-discrimination/equality and rule of law/accountability. Moreover, the key country systems that are involved in a crisis response, such as the civil service, procurement mechanisms, public financial management systems and monitoring and evaluation systems, need to incorporate and display these qualities and principles when responding to economic shocks. Otherwise, the policy measures implemented will be either short-lived or unsustainable.

When individual institutions or entire systems adopt a combination of these governance principles and institutional capacities, governments boost their ability to formulate and implement effective anti-crisis measures that are also legitimate in the eyes of their citizens. These qualities and principles are mutually supportive: the governance principles set the overall enabling environment and drive the capacity of institutions to perform better and respond to crises, while the key institutions involved in realizing these principles need to be effective, adapt to changing circumstances and priorities, and sustain results and efforts. These key qualities and principles, when adopted by core country institutions, can help countries design and implement more inclusive policies and avoid implementing recovery measures that could erode social protection (such as cash transfers) and social services (such as health and education) (Sepulveda 2011).

Determining the ‘right’ policy recommendations for improving governance structures and institutional capacities so that countries are better equipped to respond to crises is complex. Depending on the extent of their development, countries require differing investments in capacities. In the absence of institutional capacities and effective governance, though, countries have relied on *ad hoc*, short-term measures to contain the impact of economic crises.

Countries would do better to take a longer-term view when building their institutions, which include the civil service, oversight bodies (e.g., judiciary systems), public financial management and national procurement systems. By so doing, governments could better sustain their development gains, regardless of their political and historical backgrounds. Without investments in such core structures and systems, countries may employ short-term measures (such as the establishment of task forces, coordination mechanisms and other similar institutional arrangements) that bring about quick gains, but that, not being systemically incorporated, leave countries ill-prepared in the (inevitable) event of future crisis.



Institutional Capacities and Qualities

Countries that strive to respond effectively to crises and to build resilience need adaptable, capable institutions. A better understanding of how institutional capacities within countries form a building block for effective responses to economic shocks is essential for sustaining human development gains, including progress towards the MDGs. This section discusses the qualities necessary for institutions at the forefront of the crisis response, provides country evidence, and proposes measurements and recommendations. Institutions mentioned in this chapter are defined as formal organizations of government and public service, including government ministries and agencies, sub-national governments and other organizations of states responsible for public services, the design and implementation of policies, and the administration of the state's functions.¹

Defining Institutional Qualities

Performance, adaptability and stability are the three qualities critical for any effective response to a crisis. While institutional performance is the foundation of state capacity to function and fulfil its obligations towards its citizens, it is not a sufficient condition for countries that need to respond to shocks and deal with a changing environment. Building resilience also requires institutions that are stable, yet adaptable.

While institutional performance is the foundation of state capacity to function and fulfil its obligations towards its citizens, it is not a sufficient condition for countries that need to respond to shocks and deal with a changing environment. Building resilience also requires institutions that are stable, yet adaptable.

Performance — Performing institutions, with the capacity to deliver basic public services and to design and implement policies, are critically important to countries' efforts to achieve their development goals, and even more so during crisis. For example, the quality of governance, as measured by the level of corruption and the quality of bureaucracy, can explain differences in the ability of public spending to improve health and education (Rajkumar and Swaroop 2008). Measured by effectiveness and efficiency, institutional performance is the foundation of the state's capacity to manage its executive, legislative and judiciary functions, to administer the economy, to deliver social services, to use natural resources sustainably, to ensure protection of human, economic and social, civil and political rights, and to provide security (UNDP 2010). Effectiveness is the degree to which an institution's objectives are achieved, and an understanding of where and how an institution is more or less effective can help people to design programmatic responses to develop capacities in these particular areas. Efficiency is the ratio of produced outputs (or what has been achieved) to the resources used to create them (money, time, labour, etc.). The effects of improved efficiency extend beyond obvious cost-saving factors, and recent research shows a direct relationship between public sector operational efficiency and economic growth (Public Choice 2008). Furthermore, higher efficiency in public sector organizations improves the image and public legitimacy² of the government.

Adaptability — In times of crisis, countries need institutions with the capacity to anticipate, adapt and respond to changing needs and shifting priorities. Adaptability is thus an ability to perform in future conditions and to innovate to meet future needs (UNDP 2010). Adaptable institutions are flexible and able to continuously invest in endogenous improvements, while anticipating and responding to crises with innovative solutions (UNDP 2010 and Killick 1995). Such institutions form a foundation for building longer-term resilience.



Governance Principles, Institutional Capacity and Quality

Investments in innovation³ comprise cutting-edge changes to policies, processes, practices and behaviour that would lead to better and more sustainable performance (UNDP 2010). Some *ad hoc* changes can be introduced in reaction to external factors (e.g., the establishment of crisis response task forces within ministries of finance or central banks). Most changes, though, require preparation to adapt to anticipated changes in external and internal environments (e.g., up-front investments in human resources, including incentive mechanisms able to attract capable new graduates to government institutions). Such continuous and endogenous improvement can ensure adaptability.

Stability — Stability is the degree to which an institution can decrease volatility of performance through institutionalization of good practices and norms and can identify and mitigate internal and external risks through risk management (UNDP 2010).

Institutional innovations need to become routine, not just a temporary improvement in an institution's performance that might be followed by larger setbacks (e.g., when a crisis response task force is dismantled after the crisis). The reasons for this are compelling: Stable institutions are able to decrease the volatility and unpredictability of their performance and resource utilization through the institutionalization of good practices and innovative norms. When innovative procedures, institutional arrangements, mechanisms, and other interventions that have proven effective are systematized, they ensure continuous and consistent institutional performance.

A stable institution should be able to design and implement proper risk identification, analysis and management (UNDP 2010). An institution with an overall risk management strategy that addresses risks holistically, rather than with a loose patchwork of plans from various departments or teams, is often better able to mitigate risk and is less susceptible to major threats, thereby ensuring stability. An example of this would be the establishment of a permanent economic analysis/surveillance and policy advisory unit within a government's ministry of finance.

Measuring Change in Institutional Performance, Adaptability and Stability⁴

Improvements in institutional qualities can be measured by an institution's ability to: a) convert inputs into productive use (performance); b) adapt to changing realities and demands (adaptability); and c) seek resolution to problems and remove barriers (stability). Annex 8.A provides a summary of measurements and indicators to track changes in institutional performance, adaptability and stability.

Performance — As defined earlier, performance consists of the effectiveness and the efficiency with which an institution fulfils its purpose. Indicators of increased effectiveness could be quality (e.g., through definition of quality standards or a quality assurance mechanism) or adequacy of output quantity (e.g., the quantity of the products and services required to meet the needs of beneficiaries). For example, programmatic responses may contribute to increased effectiveness by:

- improving the quality of policy (e.g., by better analysing the crisis and formulating an adequate and effective response in times of crisis)
- improving the implementation of programmes (e.g., by having better talent management systems that attract and retain top talent in policy advisory and development units, with the capacity to analyse crisis situations and develop policy responses).



Indicators of increased efficiency could be the degree of clarity of roles and responsibilities, client needs and values, or expected outcomes; degree of alignment between teams, budget allocations, or monitoring and evaluation systems; or efficient business processes that reduce the time required to identify, develop, and deliver outputs. A programmatic response may contribute to increased efficiency by:

- aligning organizational structure to the mandate in order to reduce overlapping roles and responsibilities (e.g., establishing a crisis response task team with a clear mandate, role and responsibilities in times of crisis)
- streamlining business processes by reducing the time required to complete tasks or the number of people whose approval is required, as the introduction of fast-track procedures is critical in time of crisis
- improving the policy formulation process by involving more stakeholders (e.g., by coordinating the responses of government ministries in times of crisis).

Adaptability — Measures of institutional adaptability are levels of/investments in innovation, and the existence of systematic reviews of policies, procedures and business processes. A programmatic response could involve the design and implementation of a built-in mechanism for continuous improvement, such that an institution's effectiveness and efficiency are examined, redefined and realigned continuously in response to changing realities (by offering, *inter alia*, training to staff that addresses specific needs within the institution, including skills for complex data analysis and policy development).

Stability — While measures of performance provide a static image of how well an institution uses its resources, measures of stability provide a dynamic representation of how well an institution performs over time through its incorporation of good practices and policies (e.g., its use of standard operating procedures and adherence to regulations) and risk mitigation mechanisms (e.g., reduced staff turnover and measures to improve transparency and accountability). Identifying and analysing areas that are particularly subject to variable performance — due to, for instance, changes in political or organizational leadership or high staff turnover — can reveal which areas need programmatic responses. Possible interventions that may foster institutionalization of good practices include:

- documentation of business processes
- alignment of business processes, competency requirements and performance management, such as by hiring people with the needed skills, having them do the right things, and rewarding them for doing it well
- development of a knowledge-sharing mechanism to share good practices and retain institutional memory.

Programmatic responses may contribute to better risk mitigation by:

- designing and implementing participation mechanisms
- drafting and implementing best practice policies and practices
- developing information management systems to ensure fact-based decision-making.



Governance Principles, Institutional Capacity and Quality

Application of Institutional Qualities to Core Country Systems and Country Evidence

The qualities defined above — performance, adaptability and stability — are critical to country systems, which are at the forefront of crisis response, and are responsible for ensuring that the available capacities, assets and resources are used as efficiently and effectively as possible. The country systems comprise legislation, policies, procedures and organizational structures needed for the functioning of the state and include human resource management/civil service, public financial management (PFM), procurement and monitoring and evaluation systems.⁵ This section focuses on four core systems: civil service, PFM, procurement, and monitoring and evaluation. These are critical for an effective response to a crisis and for the sustainability of MDGs and other development goals. The examples and evidence below demonstrate, especially in light of the recent economic crisis, how the key institutional qualities of performance, adaptability and stability have been applied to these core systems in times of crises.

Civil Service

Of the many institutions that are mobilized to respond to a crisis, the civil service⁶ at the national and local levels is a key system on which the state relies to fulfil its obligations towards its citizens. Thus, to function effectively and reach its development agenda, a country must prioritize investments in a professional, merit-based civil service and strengthen local governments responsible for overseeing or delivering basic social services, especially to the poor and other vulnerable groups (Kohli 2004).⁷ The experience of countries in responding to the recent economic shock has shown that the capacity of institutions to provide evidence-based analysis of the situation and sound policy options to address the crisis is critical. This fundamental capacity is grounded on the continuous availability of experienced and well-trained staff in key government institutions and central economic agencies, such as ministries of planning, finance and central banks (Nelson 1990, ODI 2010).

The lack of a predictable, coherent and functioning bureaucracy undermines the ability of developing countries to respond to crises (Evans 1992). The World Bank found that one quarter of developing countries could not contain the effects of poverty secondary to the economic crisis due to weak underlying capacities (World Bank 2009). Recent Overseas Development Institute (ODI) research also pointed out weak state and institutional capacities that impeded the ability of states to establish effective and sustainable policy responses to the economic crisis (ODI 2010). Prolonged underinvestment in the civil service, including education policies that neglect investments in specialized tertiary education,⁸ can lead to a failure to produce a cadre with the skills and competencies to build an effective and ethical civil service or to the crowding out of skilled talent from the public sector (to the private sector).

A recent study on the 2008 economic crisis response, conducted by the UNDP-supported Regional Centre for Public Administration Reform (RCPAR), found that ineffective and inconsistent responses in some countries in Eastern Europe and Central Asia have exposed underlying weaknesses within their public sectors. Underinvestment in the professional civil service system has affected their capacity for strategic and evidence-based policy-making and coordination, effective public finance management, budget planning and execution, and effective delivery of public services. The same study also revealed that the economic crisis halted, or at least stunted, reform processes that were underway in many countries to modernize the state apparatus, including civil service and public administration reforms, decentralization processes, and others. Countries in which reform processes were still underway and that had only been able to lay the foundations of a modern state, were unable to implement effective measures to mitigate the impact. This is particularly



true for their sub-national governance structures, which have suffered from a cessation of efforts to improve their ability to fulfil their increasing responsibilities for the delivery of basic services to local communities.⁹

In time of crisis, particularly in countries where chronic underinvestment in the civil service has failed to build competent bureaucracies, institutions need to be able to quickly adjust to the new challenge and to establish workable mechanisms and arrangements that boost their capacities to design and implement effective counter-crisis policies. While each country context requires its own specific set of interventions and policy options, all countries can enhance their institutional capacity by introducing short-term measures, such as offering incentives to attract competent and educated members of the diaspora to support their country's response to the crisis. Sometimes, the skills and the competencies might already be within the country, but might be scattered across different state institutions or working in the private sector. In these countries, the establishment of task forces and committees and the promotion of public-private partnerships would allow institutions at the forefront of the crisis response to temporarily draw on these resources. Faced with a lack of strong performing systems, and especially with a lack of a vital civil service, states have resorted to short-term, *ad hoc* responses to contain crises. Examples of these are detailed below.

In Bangladesh, the government formed a number of multi-sectoral task forces and committees to monitor the crisis and articulate policy adjustments.¹⁰ These task forces included a committee, headed by the minister of finance and comprising competent public and private sector experts, such as cabinet ministers and policy makers, researchers and analysts. Nigeria established the Presidential Steering Committee on the Global Economic Crisis as well as the Presidential Advisory Team to propose measures to reverse the declining trend in its capital markets. Kenya and the Sudan established coordination mechanisms to ensure communication and consultation between key government departments (i.e., the Prime Minister's office and the Ministry of Finance) and other key institutions (central banks). Kenya also set up a taskforce, comprised of officers from the Ministry of Finance and Planning as well as the Central Bank, to look into ways of cushioning the economy from the adverse effects of the crisis. The United Republic of Tanzania and Zambia, instead, established broader multi-stakeholder consultative mechanisms and processes.

While each country context requires its own specific set of interventions and policy options, all countries can enhance their institutional capacity by introducing short-term measures, such as offering incentives to attract competent and educated members of the diaspora to support their country's response to the crisis.

While the degree of effectiveness of such task forces and other institutional arrangements established within ministries of finance and central banks to respond to the crisis is not clear, examples from Bangladesh, the United Republic of Tanzania and Mauritius show that, where these mechanisms for policy development and coordination have been institutionalized, countries have had greater capacity to develop and implement more coordinated policy responses to the 2008 economic crisis (ODI 2009 and 2011).

For instance, the experience of Lebanon in responding to the recent economic crisis attests to the effectiveness of past investments in capacity to reform its Ministry of Finance. Staffed with well-trained and highly skilled Lebanese professionals, the Ministry's Economic and Technical Support Unit (ETSU) played a critical role in the aftermath of the financial crisis by providing high-level policy advice to the government to address short-term effects of the crisis. Formed (with support from UNDP) at the beginning of the 1990s as a temporary



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economic advisory body and staffed with Lebanese diaspora, ETSU is the main body in charge of providing up-to-date economic analysis, research and policy advice to the government. The progressive integration of its staff into the Ministry and the institutionalization of ETSU have been ensuring consistency in institutional performance and retention of capacity.¹¹

While putting in place short-term measures, such as task forces or policy advisory units equipped with high-calibre professionals, provides institutions with the short-term capacity to respond to a crisis, institutionalizing such measures allows countries to remain responsive. Thus, countries that would like to deal more effectively with future shocks and become more resilient should implement, in tandem with short-term and *ad hoc* measures, medium- and long-term strategies that address underlying institutional weaknesses.

Public Financial Management Systems

The adequate performance of PFM systems — which comprise, *inter alia*, institutions in charge of developing and executing national and local budgets, setting fiscal frameworks, collecting taxes, and performing financial accounting and reporting (Renzio 2010) — is necessary for an effective response to an economic crisis. The World Bank (2009) broadly identifies country resilience with the capacity to promptly scale up

public expenditures and to protect vulnerable groups through poverty reduction programmes. According to the Country Policy and Institutional Assessment (CPIA), one of the primary indicators for assessing a country's resilience is its institutional abilities to manage the budget process, design and implement policies, provide services, and deliver accountable and transparent government.¹² Well-performing PFM systems become particularly relevant during an economic downturn, when countries' — and particularly developing countries' — fiscal positions deteriorate (i.e., declining government revenues, including lower ODA

Well-performing PFM systems become particularly relevant during an economic downturn, when countries', particularly developing countries', fiscal positions deteriorate.

(i.e., declining government revenues, including lower ODA predictability, declining tax collection, contracting trade, etc.). Experience from previous crises indicates that budget constraints harm the quality of budget management and implementation (as when, for instance, activities are moved off-budget, spending is determined by unplanned decisions, regular budget and control procedures are circumvented, the credibility and reliability of budget planning are reduced, etc.) and lead to increased corruption and mismanagement.¹³ These weaknesses compromise the design, execution and monitoring of countries' responses to crises. Investing in reforms aimed at strengthening PFM systems, including budget management, is therefore critical to prepare countries for an effective and efficient response to future economic crises.

While the specifics of PFM reform depend on the degree of robustness, or weakness, of a country's PFM systems, key elements of such reforms may include, but need not be limited to, strengthening mid-year budget and macro-fiscal framework reviews to align annual budgets to the new fiscal situation; strengthening the capacity for developing and costing capital projects to ensure that they adequately address the needs of the crisis response; improving the capacity for cash forecasting and debt management for sound budget financing; introducing more robust and transparent budget execution procedures, ensuring that budget rationing is based on pre-defined expenditure priorities that have been established by clear political processes (i.e., cabinet sub-committees) rather than arbitrarily by finance ministries; introducing more rigorous expenditure review processes to eliminate inefficiencies; and establishing contingency funds for emergencies. Since



a country's response to a fiscal stress (e.g., stimulus packages, tightening of social spending, etc.) affects current and future generations, countries must also include more transparent budget processes in their PFM reforms.¹⁴ Policy decisions on budget spending need to be clearly articulated and communicated to citizens.

A cross-country study conducted by the ODI finds a positive and significant correlation between countries' income levels and the quality of their PFM systems (de Renzio 2009). Although it is not possible to determine either the existence of a causal relationship or (if there is one) its direction, one can nevertheless strongly argue that investments in PFM systems eventually lead to higher income levels and thus to increased capacity to respond to economic shocks (i.e., because more resources are available). De Renzio's contention, though, is that income levels generate the necessity and pressure for governments to improve PFM systems while governments also invest in capacities to sustain such improvements. The study also finds a significant and positive relationship between aid dependency and the quality of PFM systems (measured through the PFM Performance Measurement Framework).¹⁵ Here again, though, it is not possible to determine either the existence of a causal relationship or (if there is one) its direction, and so it is not possible to draw policy conclusions: while higher levels of aid dependency may lead to donor-supported PFM reform programmes, countries with relatively better PFM systems are able to attract more aid and thus to increase their capacity (fiscal space) to respond to crises.

As described earlier, the establishment of social protection mechanisms to protect the poor requires more money. Yet, many countries, especially poor and aid-dependent ones, have very limited resources, as short-term budget balancing or tight deficit control often outweighs longer-term considerations.

Building good national procurement systems or strengthening existing ones is especially important for countries that are dependent on imports of essential goods and services, such as foodstuffs, at times of soaring food prices.

Procurement

Public procurement accounts for most of government budgets; indeed, in Africa, it accounts for as much as 70 percent of government budgets.¹⁶ The performance of procurement systems is especially important for aid-dependent countries that seek to develop countercyclical measures during economic crisis and/or that rely on timely imports of essential goods and services, such as basic foodstuffs, to protect their vulnerable citizens. In this respect, good national procurement systems play a pivotal role in preventing misuse and leakages of public resources, in curbing corruption, and in ensuring that public investments in goods and services are of standard quality and quantity.¹⁷ For example, responding to crises by creating labour- and capital-intensive works, such as large public infrastructure programmes, requires the availability of robust procurement systems capable of delivering large infrastructure projects transparently and effectively. In developing countries, where systems are weak, these projects are particularly subject to resource leakages and rampant corruption. Building robust procurement systems and reforming them is most needed, not only to minimize the effects of the crises by supporting the implementation of countercyclical programmes (i.e., public procurement of foodstuffs), but also to restore the levels of economic growth and development gains that the crises have eroded. For example, since recovering from the Asian financial crisis of the late 1990s, the Government of Indonesia identified weaknesses in its procurement and services delivery as a contributing factor to worsening the effect of the crisis, and thus embarked on a large-scale reform of its national public procurement system, to better prepare for future shocks.¹⁸



Building good national procurement systems or strengthening existing ones is especially important for countries that are dependent on imports of essential goods and services, such as foodstuffs, at times of soaring food prices. Least-developed landlocked countries (LLDCs), such as Malawi and the Niger, need robust procurement systems to import food and other essential goods. The underlying cause for increased dependence on imports in the Niger is the structural adjustment programmes, such as trade liberalization, that were implemented beginning in 1994 and have caused the gradual depletion of food reserves and been replaced by monetized equivalents (Deotti 2006). Capacity deficits within national procurement systems, compounded by inefficient domestic and regional markets, contributed to the overall worsening of the

impact of the recent food price crises on the nutritional level of the poor and on the availability of food, even when Malawi and the Niger were able to take relatively strong anti-poverty and social protection measures.¹⁹

Procurement policies also play a pivotal role during crises when they economically empower the poor and other vulnerable social groups by, for instance, promoting local hiring practices or by opening procurement and contract opportunities to SMEs, women- and minority-owned businesses, and community-based organizations.

Reliable data and monitoring and evaluation systems at the national and local levels are critical for designing evidence-based responses and targeting interventions.

Monitoring and Evaluation

The complexity and scope of the recent global economic crisis have affirmed the need for accessing real-time data on the impact of economic (and other) shocks. Reliable data and monitoring and evaluation systems at the national and local levels are critical for designing evidence-based responses and targeting interventions.

When the economic crisis unfolded in 2008, some Eastern European and Central Asian countries did not have up-to-date and policy-relevant statistical data to collect baseline information necessary for evidence-based policy formulation, implementation, and impact assessments. Weak monitoring and weak analysis of economic trends left countries such as Kazakhstan, Hungary, and Serbia without a deeper understanding of the effect of the crisis on their populations and industries; consequently, such countries were unable to sufficiently mitigate the impact (RCPAR and UNDP 2011).

Statistical systems that provide consolidated socio-economic information about households, such as Brazil's single registry system (Mostafa and da Sliva 2007), proved useful in expanding existing social protection programmes through top-ups or in identifying new vulnerable households. In contrast, institutions in Kenya, the Sudan, Uganda, Zambia and the United Republic of Tanzania lacked the necessary research and analytical capabilities to identify and quantify the effects of the crisis (ODI 2011). In Uganda, the analytical tools available to the Ministry of Finance, Planning and Economic Development and the Bank of Uganda were inadequate to capture the full impact of the crisis. In the Sudan, the Ministry of Finance and National Economy did not possess the trained staff with the skills to analyse the extent and depth of the economic crisis. In addition, these countries did not have policy centres or think tanks capable of producing sound policy recommendations to support an informed decision-making process (ODI 2010). Countries that want to better prepare for future shocks thus need to invest in long-term reform processes that build or address underlying weaknesses of country systems, including PFM, procurement and monitoring and evaluation systems.



Governance Principles

Core values and principles of democratic governance²⁰ are important means of achieving and maintaining development goals as recognized by UN member states in the Millennium Declaration in 2000 and include: participation; equity, non-discrimination and inclusiveness; gender equality; rules-based; transparency; and accountability and responsiveness. They are congruent with key human rights principles set out in a variety of UN declarations and conventions and can be summarized in three core principles:²¹ participation and inclusion,²² accountability and rule of law²³ and equality and non-discrimination (UNDP 2010b).²⁴

Definition of Core Governance Principles and Country Examples

Participation and Inclusion

Participation and inclusion include empowerment through representation in government and through other (e.g., administrative and local) mechanisms facilitating free, active and meaningful participation in decision-making processes. In economic crises, the participation of civil society in the formulation and adoption of crisis responses has been recognized as being particularly useful in providing alternative sources of information — and thus in framing policy debates (IDEA 2010) — as well as in increasing citizens' ownership of results (RCPAR and UNDP 2011). Some argue that democratic mechanisms such as civic participation in political processes lead to political instability, but the evidence shows that the reverse is often true: even though socio-political unrest and handovers of power do occur more often in democracies than in dictatorships, they do not disrupt the overall development process as they do in dictatorships (UNDP 2000).

Further, participatory political regimes generally deliver better growth because they produce 'superior institutions' better-suited to local conditions for a number of reasons: participatory political regimes yield more predictable long-term growth rates and have more stability, since the wider range of decision makers results in greater diversification and lower risk in an environment rife with imperfect information (Rodrik 2000). Participatory political regimes also deliver better distributional outcomes by producing greater equality (Rodrik 2000).

Better development outcomes, especially in times of crisis, can be explained through the core characteristics of representative government: shared power, openness, and adaptability. Shared power fosters a climate of innovation and entrepreneurship, reflective policy-making, and thus steady growth; openness promotes the exchange of information and ideas, and greater efficiency (e.g., in the allocation and use of resources); and adaptability (i.e., the flow of ideas among public, private and civic sectors) promotes greater versatility, timeliness and flexibility in the adoption and implementation of policies, while the legitimate regular renewal of political leadership avoids conflict and allows for innovation (Halperin et al. 2010).

Meaningful and free participation of citizens and stakeholders in decision-making processes during times of crises contributes to the overall adaptability and stability of institutions and promotes innovative policy dialogues. In the Asian financial crisis of the 1990s, mechanisms of participation, consultation, and bargaining in Thailand and the Republic of Korea enabled policy makers to fashion the consensus needed to undertake the necessary policy adjustments decisively and thus to handle the crisis significantly better than Indonesia (Rodrik 2000). Generally, the hardest hit countries in an economic crisis tended to be those with few political liberties, such as Syrian Arab Republic, Algeria, Panama, and Gabon, while countries with open political regimes, such as Costa Rica, Botswana, Barbados, and India, fared much better (Rodrik 2000).



Box 8.1: Moldova's National Participation Council

Following the July 2009 elections in Moldova, the government in February 2010 established the National Participation Council as an advisory body and a liaison between the government, civil society, and the private sector. The Council consists of 30 members representing Civil Society Organizations (CSOs) from various fields whose primary task is 1) to participate in policy-making through providing expert opinions on draft policies and strategic

documents and conducting and presenting independent assessments of policies' impacts; and 2) to contribute to establishing the institutional framework for consultation. The government involved the Council in the consultation process when developing the anti-crisis legislation, which allowed for the measures to better reflect the needs and concerns of the public.

Source: United Nations Development Programme/Bratislava Regional Centre and Regional Centre for Public Administration Reform, 2011, *Economic Crisis Responses from a Governance Perspective in Eastern Europe and Central Asia: Regional Report*; Asipovich, H., 2010, 'Country Report: Moldova', *The International Journal of Not-for-Profit Law*, Vol. 12, Issue No. 4..

Using a methodology called the called Prospective Political Analysis and Prospective Scenarios Project (PAPEP, for its Spanish acronym) that provides a political economy analysis in highly political decision-making processes in the face of an economic crisis,²⁵ UNDP contributed to consensus building in various countries, particularly in Latin America, that faced tough decisions because of economic crisis.²⁶ For example, the PAPEP methodology was employed in El Salvador during 2008–2009 when that country was embroiled in the global economic crisis and a new government was in power there. The process helped build a consensus with the opposition party about the best policies to adopt for economic recovery and contributed to the smooth transition of power.²⁷

Accountability and Rule of Law

Participation hinges on effective accountability and rule of law. With regards to the current crisis, it has been recognized that, "[as] governments assume a broader, more significant role in response to the crisis, it becomes even more important that they are effective and accountable — otherwise, they would compound the severity of the problems" (Peters et al., n/d). Empirical research has substantiated this more and more. For example, research shows that, when opposition parties draw attention to the effects of a crisis, governments will have greater incentive to prevent crises such as famines (Sen 1999 and UNDP 2000). Thus, greater accountability on the part of leaders and the ability of the system to advance popular demands and negotiate distributive pressures can lead to more concerted and effective policy responses to a crisis such as an economic downturn and thus provide a source of resilience (IDEA 2010).

Where the rule of law exists, it is easier to manage potential conflicts during crisis. In the Republic of Korea and Thailand, for example, democratic processes facilitated a smooth transfer of power from a discredited set of politicians to a new government through institutionalized mechanisms of 'voice'; consequently, the Korean and Thai institutions obviated the need for riots, protests, and other kinds of disruptive actions by affected groups (Rodrik 2000).

An effective rule of law can also support reforms or adaptation processes within state functions and overall government performance. Some countries, such as Kenya and the Sudan, have specific institutional arrangements to ensure communication and consultation between key government departments (e.g., the



Prime Minister's office and the Ministry of Finance) and with other key institutions such as central banks (ODI 2011). Other countries, such as Kazakhstan and Latvia, have tried to merge state assets and optimize expenditure (UNDP 2011).

Non-Discrimination and Equality

Equality addresses power inequalities (be they political, economic, legal, or cultural) and requires the extension of development gains to the most excluded groups and individuals (OHCHR 2008). Institutions that ensure non-discrimination and equality can mitigate the effects of a crisis on the most vulnerable, such as through the facilitated ring-fencing of social expenditure and the prevention of the erosion of normative standards in times of crisis. Some countries have strong governance mechanisms that can be used to this end during an economic crisis, for example, the judiciary system (see Box 8.2).

An increasing body of literature on states in fragile situations refers to principles such as those discussed above and stresses that they generate an important driver for organizational legitimacy.²⁸ The argument is that an organizational legitimacy, understood as a societal acceptance of regimes and institutions, affects the effective exercise of power and authority. This will be further discussed below in the section on linkages.

Measures of Governance Principles

There have been numerous efforts to develop indicators for governance. Many focus strongly on measuring political freedoms and the rule of law. A recent World Bank study, summarized below, contains a useful discussion of indicators for measuring the three core governance principles discussed in this paper (World Bank 2010).²⁹ These indicators are meant to be descriptive and illustrative, not prescriptive or comprehensive:

- Regarding equality and non-discrimination, the study suggests indicators that target exclusion, discrimination, and inequality in general, and that can be developed through disaggregation of data not only by gender, but also by age, citizenship, etc. In general, indicators related to equality should focus more on the most excluded and vulnerable groups.
- Regarding accountability, the study proposes indicators that capture mechanisms of monitoring and independent oversight (such as establishment of ombudsmen's offices, and human rights monitoring

Box 8.2: Role of the Judiciary System in Crisis Response

In Latvia, the Parliament voted in December 2009 to further shrink the 2010 budget through spending cuts and tax increases, including a 10 percent decrease in pensions and a 70 percent decrease for working pensioners. Later that month, the Constitutional Court ruled the pension cuts unconstitutional on the grounds that they violated residents' right to social security. As a result, the cuts had to be reversed.

In Romania, 15 percent pension cuts proposed in May 2010 were declared unconstitutional the following month. Although pensions partly funded by worker contributions are constitutionally protected, the government had circumvented this protection on the grounds of a separate constitutional article allowing the temporary limitation of certain rights in order to defend national security.

Source: United Nations Development Programme/Bratislava Regional Centre and Regional Centre for Public Administration Reform, 2011, *Economic Crisis Responses from a Governance Perspective in Eastern Europe and Central Asia: Regional Report*.



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at the domestic level), institutionalization of complaints facilities that are anchored in national institutions or in specific parts of the executive branch, as well as access to formal and informal justice (such as local and community dispute resolution mechanisms and those that link formal and informal systems).

- Regarding participation, the study proposes indicators that can capture civil society involvement in policy processes such as the poverty reduction strategies, processes of advocacy and empowerment (e.g., dialogues, collaborative activism, and community participation by specific groups), and legal outcomes, such as the establishment of laws allowing the flourishing of an independent civil society.

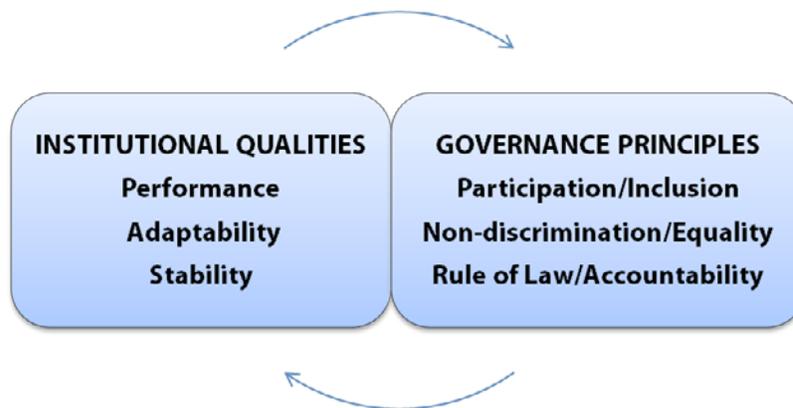
UNDP’s Governance Assessment Programme has compiled another useful report presenting an overview of 35 sources of governance indicators (UNDP 2007).³⁰ Based on this study, the most common categorizations of governance indicators are:

- Input/rights/commitment/*de jure* — at this level, the indicators might typically cover commitments made by countries, including national constitutions and commitment to international treaties.
- Process/responsibility/*de facto* — these would include the existence of functioning institutions to ensure that obligations are fulfilled and would typically look at processes documenting the fulfilment of these responsibilities and commitments.
- Output/outcome/enjoyment/performance/*de facto* — this type of data would typically look at the number of people enjoying or not enjoying their economic, social and civic rights, and would include indicators of the results of commitments, for example, the percentage of government spending for the poor and vulnerable, as verified by an independent audit.

Linkages Between Institutional Qualities and Key Governance Principles

The institutional qualities and governance principles mentioned above are interlinked and mutually supportive, as Chart 8.1 illustrates.

Chart 8.1: Linkages





On the one hand, governance principles provide the environment that enables institutions to perform, adapt and remain stable, especially in a crisis. For example, ensuring that state institutions account for decisions, actions and results (accountability) makes these institutions more efficient and effective in addressing the changing needs and demands of a society (performance). Another example that illustrates the enabling effect of governance concerns participation: as described earlier, involving people in decision-making processes (participation) helps institutions become more responsive and to gain more legitimacy, especially when faced with tough choices amidst resource scarcity (adaptability).

On the other hand, institutions responsible for realizing and upholding these governance principles need to perform, adapt and be stable. This means that institutions responsible for ensuring accountability (e.g., anti-corruptions commissions, judicial bodies, ombudsmen's offices, parliaments) also need to perform well to fulfil their mandates and to gain legitimacy. With regard to participation, institutions and mechanisms that ensure participation (such as town hall meetings of local governments and local boards for service provision) also need to be able to adapt to better respond to beneficiaries' needs.³¹

The interrelationship between these governance principles and institutional qualities as described above is valid in any development situation. Nevertheless, as country examples in this report show (and as highlighted below), these linkages between institutional qualities and governance principles seem to be particularly important to ensure governments' effective response to an economic crisis:

- Where task forces and mechanisms for policy development and coordination have been institutionalized (rule of law), countries have had greater capacity to develop and implement more coordinated policy responses to an economic crisis (adaptability), as in the cases of Mauritius, Bangladesh, the United Republic of Tanzania and Lebanon.
- The effective rule of law can also support adaptation processes within state functions and government performance under distress. For example, in a country with a clear system of checks and balances and institutional arrangements, it is easier to introduce complementary or alternative mechanisms needed to boost the effectiveness of a response to a crisis, including the ability of the country to respond to citizens' demands and to negotiate distributive pressures (IDEA 2010).
- Broad stakeholder participation ensures innovation and policy dialogue and thus adaptability of institutions. For example, realizing the centrality of innovation for building greater resilience to respond to shocks, Chile has been investing in the past decade in strengthening its capacities to develop innovative policies and to move away from ineffective *ad hoc* development interventions (IDB 2010).³²

The concept of organizational legitimacy mentioned above similarly demonstrates the linkages between institutional qualities and governance principles. Much of the current literature mentions several sources of legitimacy.³³ For state institutions in the process of responding to an economic crisis, two sources seem particularly relevant: 1) input or process legitimacy, when the legitimacy of the organization or institution is tied to agreed rules and procedures that govern decision-making processes, including the organization of participatory measures; and 2) output or performance legitimacy that is defined in relation to the performance, effectiveness and quality of services and goods that the state delivers. Thus, organizations that adhere to societal expectations about their mandates, actions, structures, and performance and that build an ongoing reputation for their relevance, appropriateness and correctness are viewed as trustworthy and reliable, especially during sensitive decision-making processes as part of a response to a crisis.



Policy Recommendations and Conclusion

Developing countries, especially the LDCs, would do better to take a longer-term view when responding to crises, as the successful implementation of inclusive and equitable countercyclical measures largely depends on the countries' core systems, such as merit-based civil service, oversight bodies (such as judiciary systems), public financial mechanisms, and national implementation mechanisms (such as procurement). Not having

strong institutional capacities, countries may be forced to resort to *ad hoc* measures that may not be sustainable in the long run. If forced to resort to these measures, though, countries should nevertheless make continued investments to address underlying institutional weaknesses.

Developing countries, especially the LDCs, would do better to take a longer-term view when responding to crises, as the successful implementation of inclusive and equitable countercyclical measures largely depends on the countries' core systems.

Country examples indicate that boosting of institutional qualities within systems at the forefront of the crisis response requires continuous and endogenous improvements and changes, especially in risk analyses, upfront investments in critical human resources, and the institutionalization of good practices and norms. The main recommendations are:

- Improve the quality of implementation of anti-poverty and social protection programmes by attracting and retaining skilled national talent and by generally investing in merit-based civil service
- Frontload investments such as data collection, information and risk management systems in order to increase, relatively quickly, the core capacities needed to forecast and analyse the impact of crises, implement targeted social protection measures
- Prioritize investments to improve capacities of services delivery mechanisms at the sub-national and local levels to enable the provision of direct benefits for citizens' livelihoods
- Systematize innovative, proven and effective procedures, institutional arrangements, mechanisms, and other interventions to ensure continuous and consistent institutional performance, even during times of crises
- Invest in reforms to strengthen PFM systems, including budget management, in order to prepare countries for an effective and efficient response to future economic crises
- Strengthen national procurement systems to prevent misuse and leakages of public resources during crises (especially in countries dependent on foreign aid and/or imports of basic foodstuffs).

When key institutions involved in crisis response uphold governance principles such as inclusion/participation, rule of law/accountability and non-discrimination/equality, greater consensus, wider public support and sustainable results are more likely. Contrary to opposing claims, these can reduce transaction costs down the road. Important recommendations for the use of the governance principles identified in the report are:

- Strengthen oversight institutions (e.g., constitutional courts, national human rights institutions) in order to protect the rights of the vulnerable groups



- Improve the ability of a system or institution to negotiate, through inclusive and transparent processes, distributive measures, which can lead to more concerted and effective policy responses and thereby bolster the legitimacy of state institutions
- Institutionalize and/or strengthen participatory decision-making and consultation processes at the national level (e.g., establish civil society councils or inclusive policy round tables)
- Invest in effective ‘voice mechanisms’ that allow for the free, active and meaningful participation of citizens and stakeholders in the decision-making processes at the local level (e.g., establish local service delivery boards)
- Invest in institutions that ensure non-discrimination and equality
- Facilitate the ring-fencing of social expenditure and prevent the erosion of normative standards during crisis.

Development partners need to support countries through longer-term investments to improve the functioning of key institutions, even in the face of crisis.

While the discussed governance principles and institutional qualities are always important for the basic functioning of the state, they are particularly critical during economic crises, especially if states hope to take countercyclical measures and to protect the welfare and livelihoods of their poorest and most vulnerable citizens. Taking this route, countries can avoid implementing recovery measures that could erode social protection measures and gains in human development, including the achievement of MDGs.

Development partners need to support countries through longer-term investments to improve the functioning of key institutions, even in the face of crisis. In the case of countries heavily dependent on aid, development partners need to support the development of greater institutional and fiscal space to design and implement countercyclical measures. Partners can also provide alternative policy advisory options that put human development first. This requires a careful consideration of the dynamics of political economy (power) in order to ensure that decisions ultimately support the rights of the poor and disenfranchised.



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Notes:

1. Institutions can also be defined as “the rules of the game in a society. [...] They structure incentives in human exchange, whether political, social or economic. Institutional change shapes the way societies evolve through time and hence is the key to understanding historical change” (North 1990:3–5, in UNDP Arab Human Development Report (2002)).
2. See further deliberation on the concept of legitimacy under Governance Principles section.
3. Innovation is usually driven by capable and visionary leaders, and entails investments in capacities requiring a longer gestation period (i.e., the introduction of new institutions), such as investments in skills development and education, R&D and new technologies, and forward-looking reforms (UNDP 2010).
4. This section is a summary of UNDP (2010), *Measuring Capacity*.
5. The OECD-DAC defines country systems as national arrangements that are established in national legislation, including public financial management, procurement, audit and monitoring and evaluation, social and environmental assessments. The IDB defines procurement country systems as incorporating all policies, procedures, instruments, controls, and organizational structures that govern the acquisition of goods, works, and consulting services required by public sector institutions.
6. Civil service is part of the public human resource management system (HRM). This chapter discusses civil service only, without detailing other components of the HRM.
7. Kohli finds a high degree of correlation between superior bureaucracy and high rates of economic growth (e.g., the Republic of Korea, Taiwan, Malaysia, India), and poor quality bureaucracy and low rates of economic growth (e.g., Nigeria, the Congo, Argentina and Syria).
8. For example, Zambia no longer has a civil service academy, where newly recruited and career civil servants are trained.
9. Local governments play a critical role in addressing disparities and, by virtue of their mandate, are pivotal in identifying and delivering locally relevant social protection and MDG measures to protect vulnerable populations from the effects of crises. For more information, see UNDP (2010) *Scaling Up Support for the MDGs at the Local Level*.
10. These examples are summaries from te Velde, D. W. et al. (2009) and Foresti, M. et al. (2011).
11. Anecdotal evidence gathered by UNDP CDG. For other country stories on institutions, visit www.undp.org/capacity/publications.shtml
12. According to the World Bank study *The Global Economic Crisis: Assessing Vulnerability with a Poverty Lens* (2009), ‘the capacity of governments to cope with the impacts of the crisis’ depends on 1) fiscal capacity to absorb an increased fiscal deficit and 2) institutional capacity to implement programmes aimed at mitigating the poverty impact of the crisis. Institutional capacity in this paper is measured by a country’s capacity to efficiently and effectively scale up public expenditures and by its ability to protect the poor. The indicators to assess such capacities are derived from the World Bank’s Country Policy and Institutional Assessment (CPIA) questions 13–16, quality of budget and financial management, efficiency of revenue mobilization, quality of public administration, transparency, accountability and corruption in the public sector, and questions 10a, d, e — the quality of social protection policies and equity of public resource use.
13. IMF: www.tinyurl.com/pfm0903blog
14. *ibid.*
15. The Public Financial Management (PFM) Performance Measurement Framework, an indicator-based assessment tool, is developed by the Public Expenditure and Financial Accountability (PEFA) initiative: www.tinyurl.com/pfm-pefa
16. AfDB: www.tinyurl.com/AfDB2009nov
17. *ibid.*



18. Snapshot Assessment of Indonesia's Public Procurement System as of June, 2007 Piloting OECD/ DAC Procurement JV Baseline Indicator (BLI) Benchmarking Methodology.
19. For further details, see Cornia Giovanni (2011) *Food Security under Price Volatility*, presentation to UNDP RBA March 2011. Publication forthcoming.
20. Governance is the system of values, policies and institutions by which a society manages its economic, political and social affairs through interactions within and among the state, civil society and private sector. It is the way a society organizes itself to make and implement decisions — achieving mutual understanding, agreement and action. It comprises the mechanisms and processes for citizens and groups to articulate their interests, mediate their differences and exercise their legal rights and obligations. It is the rules, institutions and practices that set limits and provide incentives for individuals, organizations and firms. Governance, including its social, political and economic dimensions, operates at every level of human enterprise, be it the household, village, municipality, nation, region or globe. See further *UNDP Strategy Note on Governance for Human Development*, 2000.
21. As agreed in the UN Common Understand Understanding of a Human Rights Based Approach to Development Cooperation (UNDG 2003).
22. Every person and all peoples are entitled to active, free and meaningful participation in, contribution to, and enjoyment of civil, economic, social, cultural and political development in which human rights and fundamental freedoms can be realized (UNDG 2003).
23. States and other duty-bearers are answerable for the observance of human rights. In this regard, they have to comply with the legal norms and standards enshrined in human rights instruments. Where they fail to do so, aggrieved rights holders are entitled to institute proceedings for appropriate redress before a competent court or other adjudicator in accordance with the rules and procedures provided by law (UNDG 2003).
24. All individuals are equal as human beings and by virtue of the inherent dignity of each human person. All human beings are entitled to their human rights without discrimination of any kind, such as race, colour, sex, ethnicity, age, language, religion, political or other opinion, national or social origin, disability, property, birth or other status as explained by the human rights treaty bodies (UNDG 2003).
25. Political economy analysis is not a new concept, but is emerging with renewed interest and recognition from policy makers, especially given the recent political changes in the Middle East. Political economy analysis is 'concerned with the interaction of political and economic processes in a society, the distribution of power and wealth between different groups and individuals, and the processes that create, sustain and transform these relationships over time.' Such power relationships 'ultimately underpin the social contract that both enables and applies pressure on the state to be responsive, capable and inclusive' (p. 5) UNDP Political Economy Guide, 2011 (forthcoming) and OECD-DAC www.oecd.org/dac/governance/politiceconomy.
26. According to PAPEP, the following three factors contribute to the successful implementation of policies and reforms, especially in times of crises: political agreements, stakeholder consensus, and political timing.
27. UNDP Political Economy Guide, forthcoming, p. 53.
28. 'State legitimacy is the basis for rule by consent rather than coercion.' For further details, see OECD (2010) *The State's Legitimacy in Fragile Situations* and Brinkerhoff (2005) and *Organizational Legitimacy, Capacity and Capacity Development*, ECDPM. www.tinyurl.com/3jg2vgk
29. World Bank (2010), McInerney-Lankford, S. and Sano, H.-S., Human Rights Indicators in Development.
30. www.gaportal.org/sites/default/files/undp_users_guide_online_version.pdf
31. An interesting example for this comes from the application of UNDP's MDG Acceleration Framework (MAF) in Belize, where the government is now adapting the composition of local water boards to ensure better representation of rural populations, particularly indigenous peoples, who were previously left out from the process (and consequently were



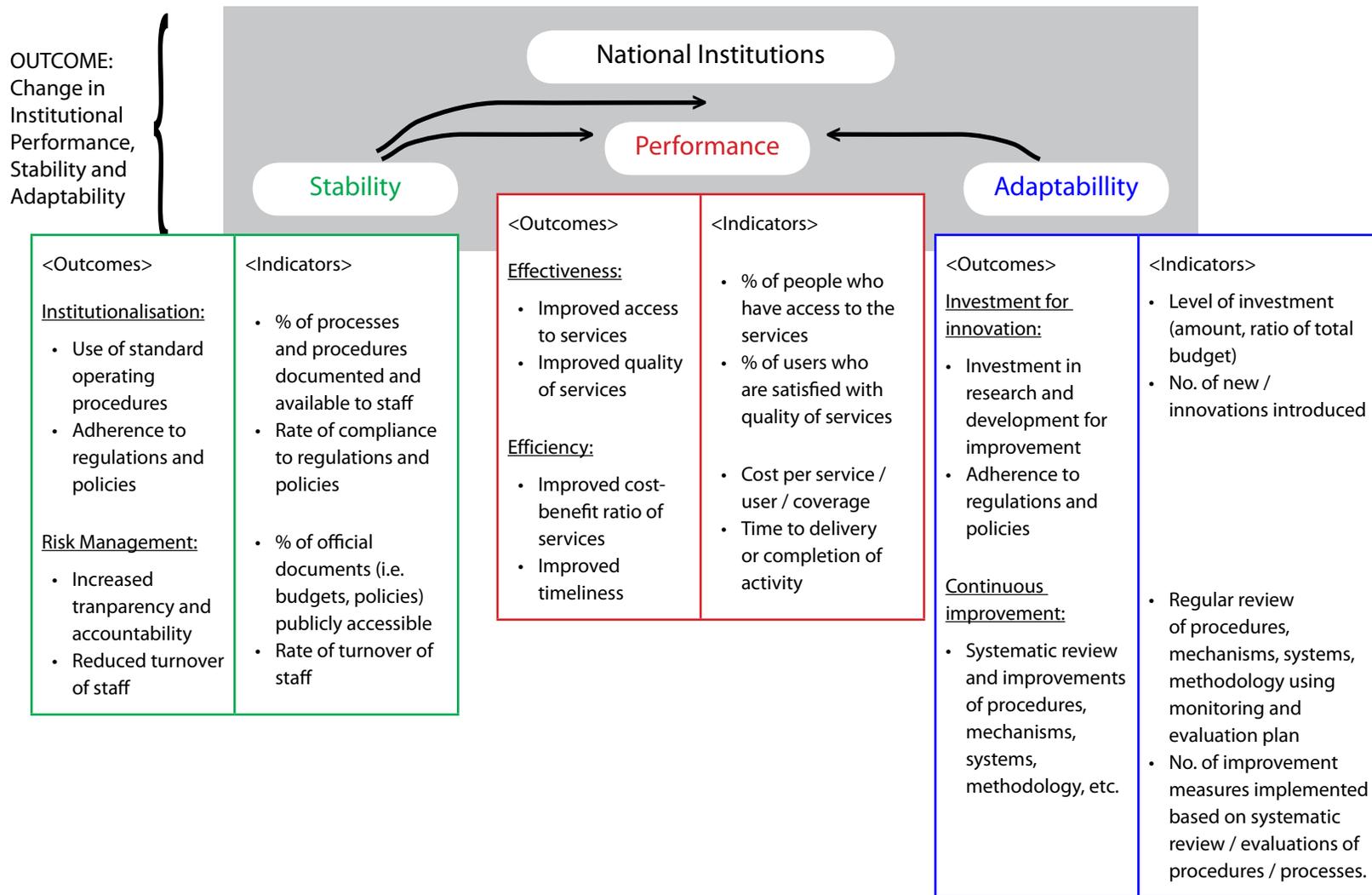
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not receiving adequate water and sanitation services). See UNDP (2010), *Unlocking progress: MDG acceleration on the road to 2015*.

32. Chile established the National Council for Innovation and Competitiveness (NCIC) and well as the Committee of Ministers of Innovation (CMD) as the national institutions in charge of developing a strategy for innovation. Regional development agencies have also been established as the institutional referent for innovation policy in the regions. Broad stakeholders' participation also ensures long-term support for innovation. As innovation takes place in networks, which have local, national and international constituencies, the agencies in charge of strategic planning and coordination of innovation policy (i.e., the NCIC and CMI) have been entrusted with promoting policy dialogue across different levels of governments and institutions, as well as civil society (IDB 2010).
33. These sources can be: input or process legitimacy, when the legitimacy of the organization or institution is tied to agreed rules of procedure through which the organization or institution takes binding decisions and organizes people's participation; output or performance legitimacy, defined in relation to the performance, effectiveness and quality of services and goods that the state delivers; shared beliefs, including a sense of political community, and beliefs shaped by social practices and structures, political ideologies, religion and tradition that allow people to see the state or other form of public authority as the overarching, rightful authority (marriage is a typical example of a legitimate institutions based on shared beliefs, even though same-sex marriage in many countries has not yet reached that level of legitimacy due to lack or weakness of shared beliefs); and international legitimacy, which is recognition of the state's sovereignty and legitimacy by external actors (this, in turn, affects its internal legitimacy). Organizations and institutions can also gain international legitimacy (e.g., the manner in which a drug enforcement agency or an anti-corruption commission gains international legitimacy through its handling of issues (e.g., drugs and corruption) that are high on the international agenda). www.tinyurl.com/ECDPM2005jun



Annex 8.A: UNDP Framework for Measuring Change in Institutional Performance, Adaptability and Stability



Source: Developed by UNDP CDG.



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